

STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF EXAMINATION

OF

**EDUCATORS HEALTH CARE
OF
MURRAY, UTAH**

AS OF

DECEMBER 31, 2001



TABLE OF CONTENTS

SALUTATION.....	2
SCOPE OF EXAMINATION.....	2
Period Covered by Examination.....	2
Examination Procedure Employed	2
Status of Adverse Findings, Material Changes in the Financial Statement, and Significant Regulatory Information Disclosed in the Previous Examination	3
HISTORY.....	3
General	3
Capital Stock.....	3
Dividends to Stockholders.....	4
Management.....	4
Conflict of Interest Procedure.....	6
Corporate Records	6
Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance	6
Surplus Debentures	6
AFFILIATED COMPANIES	7
FIDELITY BOND AND OTHER INSURANCE.....	8
PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS	8
STATUTORY DEPOSITS	8
INSURANCE PRODUCTS AND RELATED PRACTICES.....	8
Policy Forms and Underwriting	8
Territory and Plan of Operation.....	8
Advertising and Sales Material.....	9
Treatment of Policyholders.....	9
REINSURANCE	9
ACCOUNTS AND RECORDS.....	10
FINANCIAL STATEMENT.....	11
Balance Sheet.....	12
Statement of Revenue and Expenses	13
Capital and Surplus	14
COMMENTS ON FINANCIAL STATEMENT.....	15
CAPITAL AND SURPLUS	15
SUMMARY.....	16
CONCLUSION	17

June 24, 2003

Honorable Merwin U. Stewart, Commissioner
State of Utah Insurance Department
State Office Building, Room 3110
Salt Lake City, Utah 84114-6901

In accordance with your instructions and in compliance with Utah Code Annotated (U.C.A.) Title 31A, an examination of the financial condition and business affairs of

**EDUCATORS HEALTH CARE
Of
Murray, Utah**

a health maintenance organization ("HMO"), hereinafter referred to as the Organization, was conducted as of December 31, 2001.

SCOPE OF EXAMINATION

Period Covered by Examination

The Utah Insurance Department's ("Department") last financial examination of the Organization was conducted as of December 31, 1999. The current examination covers the period from January 1, 2000, through December 31, 2001, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination. The Organization's parent, Educators Mutual Insurance Association of Utah was examined concurrently.

Examination Procedure Employed

The examination included a general review and analysis of the Organization's operations and a determination of its financial condition as of December 31, 2001. The examination was conducted in accordance with generally accepted standards and procedures of regulatory authorities relating to such examinations. It included tests of the accounting records and a review of the Organization's affairs and practices to the extent deemed necessary. Permitted assets and required liabilities were valued in accordance with laws, rules, and procedures prescribed by the State of Utah.

The Organization retained the services of a certified public accounting firm to audit its financial records for the period under examination. The firm provided requested working papers prepared in connection with its audits. The use of the firm's working papers did not significantly affect the nature and extent of examination procedures performed. The firm's correspondence regarding pending or threatened litigation, claims, and assessments received from the Organization's legal representatives was relied on.

A letter of representation certifying that management has disclosed all significant matters and records was obtained from management and has been included in the examination working papers.

Status of Adverse Findings, Material Changes in the Financial Statement, and Other Significant Regulatory Information Disclosed in the Previous Examination

The previous examination reduced reported net worth by \$134,352. In accordance with U.C.A. § 31A-8-210(6), the Organization's financial condition permitted the commissioner to consider the Organization to be financially hazardous because the Organization's assets did not exceed the sum of the Organization's liabilities, minimum capital and compulsory surplus. As of the current examination date, the Organization significantly exceeded minimum capitalization requirements. (Refer to **CAPITAL AND SURPLUS**) Important points and recommendations noted in the prior examination report have been addressed by the Organization or have received further comment in this report.

HISTORY

General

The Organization is a non-profit corporation, incorporated under the laws of the State of Utah. It commenced business on October 1, 1979, and was licensed as an HMO on November 5, 1979. The Organization is not federally qualified.

No amendments were made to the Organization's articles of incorporation during the examination period. As also noted in prior examination reports, the articles of incorporation were not in compliance with U.C.A. § 31A-8-204(1) and (2) since the articles did not state:

- that the Organization is a health maintenance organization;
- that the services provided by the Organization shall be provided by persons properly licensed to perform the services;
- whether or not providers of services are subject to assessment or withholding to pay operating costs or financial deficits; and
- that principal officers be at least three separate natural persons.

Subsequent to the examination date, Restated Articles of Incorporation and amended and restated bylaws were filed with the Department. The Department notified the Organization that as part of the approval process the amended Articles of Incorporation were being reviewed.

Capital Stock

The Organization is authorized to issue 50,000 shares of no par common stock. Ten shares with an assigned value of \$33,000 each were issued and outstanding. Educators Mutual Insurance Association of Utah ("Association") owns all outstanding shares.

Dividends to Stockholders

No dividends were declared or paid during the examination period. The articles of incorporation do not permit funds received by the Organization to inure to the benefit of any shareholder.

Management

The Organization's bylaws required that the directors and officers be the same as the Association. U.C.A. § 31A-8-215 applies U.C.A. 31A-5, Part IV to HMOs. U.C.A. § 31A-5-408(2) requires shareholders to elect directors. The Organization was not in compliance with this requirement. Directors and officers serving both the Organization and the Association on December 31, 2001, were:

Board of Directors

<u>Name - Residence</u>	<u>Type</u>	<u>Principal Occupation</u>
Arlene Arnold Orem, Utah	Elected	Uniserv Director, Utah Education Association
Corey W. Callahan American Fork, Utah	Elected	Benefits Manager, Utah Valley State College
Michael R. Evans Fillmore, Utah	Elected	Teacher, Millard School District
James C. Fontaine Salt Lake City, Utah	Appointed	Retired. Previous position: CFO and Senior Vice President, Deseret Mutual Benefit Administrators
Lynette Grow Riverdale, Utah	Elected	Teacher, Weber School District
Wallace G. Harmer Salt Lake City, Utah	Elected	Business Administrator, Salt Lake City School District
Mike W. Hepner Draper, Utah	Elected	Executive Director, Utah School Employees Association
Nancy R. Jensen Centerfield, Utah	Elected	Retired.
Susan M. Kuziak Salt Lake City, Utah	Elected	Executive Director, Utah Education Association
Timothy A. Leaman Paradise, Utah	Elected	Teacher, Cache County School District
Randall R. Smart Sandy, Utah	Appointed	Attorney, Snow Nuffer, et al.
James M. Thompson Price, Utah	Elected	Teacher, Carbon High School
Scott C. Thornton Centerville, Utah	Appointed	Chief Actuary, Deseret Mutual Benefit Administrators
Carol L. Winters Orem, Utah	Elected	Accounting Assistant, Alpine School District

On December 20, 2001, the board was notified that Leonard F. Miller had resigned his position on the board. Wallace G. Harmer was appointed to serve the remaining one-year of Mr. Miller's term. At the Association's November 10, 2001, annual membership meeting, Mike W. Hepner, Susan M. Kuziak, James M. Thompson, and Carol L. Winters were reelected to three-year terms of office. R. Paul Gottfredson, Utah Association of School Business Officials, was elected to an initial three-year term.

The Organization's board did not formally appoint committees from its membership. However, because the Association managed the Organization's operations under a comprehensive management agreement, the committee members of the Association also functioned on behalf of the Organization. Board committee members as of December 31, 2001, were:

<u>Executive Committee</u>	<u>Audit Committee</u>
Wallace G. Harmer, Chair	Carol L. Winters, Chair
Susan M. Kuziak, Vice Chair	Arlene Arnold
James C. Fontaine	Wallace G. Harmer
Mike W. Hepner	Nancy R. Jensen
Carol L. Winters	James M. Thompson
Rolando I. Galano	
<u>Budget Committee</u>	<u>Legislative Committee</u>
James C. Fontaine, Chair	Mike W. Hepner, Chair
Corey W. Callahan	Lynette Grow
Michael R. Evans	Susan M. Kuziak
Timothy A. Leaman	Randall R. Smart
Scott C. Thornton	

Officers serving the Organization as of December 31, 2001 were:

<u>Officer</u>	<u>Office</u>
Rolando I. Galano	President/Chief Executive Officer
David S. Glauser	Vice President, Secretary-Treasurer
Ralph L. Colossimo	Vice President
Reagan S. Wood	Vice President
Jennifer Q. Gallegos	Vice President
Charlotte B. Poulsen	Vice President

In July 2002, Mr. Colossimo resigned from his position as Vice President of Group Marketing. Steve Morrison, the former internal auditor was subsequently appointed Vice President of Marketing.

Conflict of Interest Procedure

The Organization was managed by the Association, had no direct employees, and used the Association's conflict of interest procedures. The Association had a formal conflict of interest policy and procedure that required that employees avoid any conflict of interest between the Association and a personal business where the employee could gain personally from the relationship.

All officers and directors filed conflict of interest disclosure statements. The statement requested that the employee certify that he/she does not have any interest that conflicts or may conflict with his/her duties or judgment or list the interests that may give actual or potential conflict with his/her duties or judgment. Six of the directors listed an employer and position with an educational institution. One director listed three health related clients. One director filed an incomplete statement, which did not identify whether any conflict of interest exists or may exist.

Corporate Records

U.C.A. § 31A-8-215 applies U.C.A. § 31A-5-402, which applies U.C.A. § 16-10a-701 to the Organization. U.C.A. § 16-10a-701 requires the Organization to hold a meeting of shareholders annually at a time stated in or fixed in accordance with the bylaws. The Organization's bylaws state that an annual meeting of shareholders shall be held each year. No shareholder meetings were held during the examination period.

The minutes of board of directors' meetings were reviewed. Additionally, the minutes of the Association's directors and committee meetings were reviewed for discussions and actions relating to the Organization's operations. U.C.A. § 31A-5-407, which is made applicable by U.C.A. § 31A-8-215 requires that the board of directors manage the business and affairs of the Organization and that it may not delegate its power or responsibility, except to committees of directors as permitted by U.C.A. § 31A-5-412. The review indicated that the board did not adequately approve and support the Organization's transactions and events. Only five board of directors meetings were held during the examination period. The only item approved by the board, other than minutes of prior board meetings, was a custodial agreement. Subsequent to the examination date, the board acknowledged that each board member was furnished a copy of the last Department financial examination report.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance

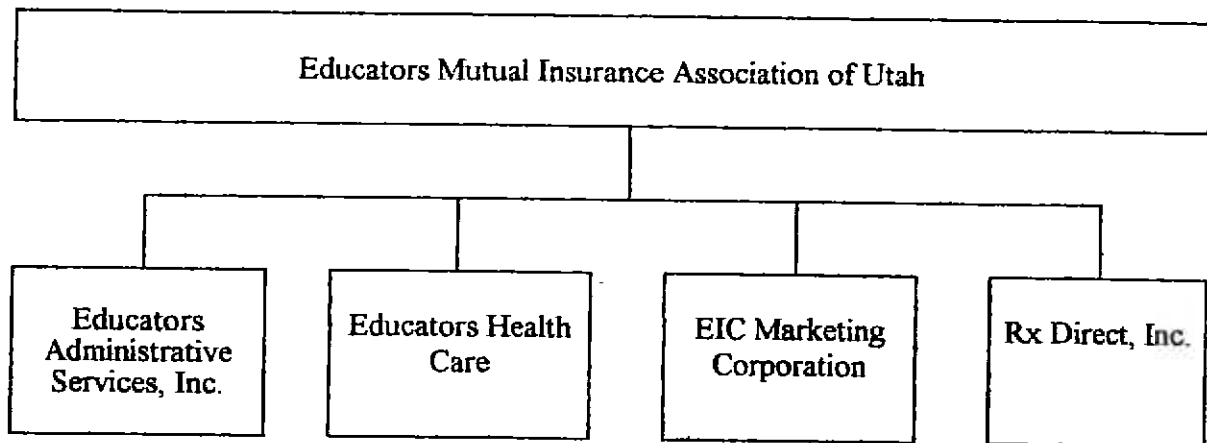
The Organization was not involved in these types of transactions during the examination period.

Surplus Debentures

The Organization did not issue or retire any debentures during the examination period nor were any surplus debentures outstanding as of the examination date.

AFFILIATED COMPANIES

The Organization is a member of an insurance holding company system as shown in the following organizational chart as of December 31, 2001.



The Association is a Utah domiciled non-profit mutual insurance company authorized to write life, annuity, and accident and health insurance. Educators Administrative Services, Inc., formerly Educators Insurance Company, is a Utah for-profit corporation, licensed as a third party administrator of life and accident and health insurance. EIC Marketing Corporation is a Utah for-profit brokerage firm organized to market insurance and employee benefit products. Rx Direct, Inc. is a Utah for-profit prescription benefit management company.

In 1998, the Association entered into an agreement to provide marketing and administrative services to the Organization. In consideration for the services and the use of the Association's panel providers, the Organization was required to pay the Association .075% of all premiums received. The agreement was amended on December 28, 2001, to require the Organization to pay a sum equal to 9.2% of all dental premiums received by the Organization.

The Organization did not notify the Commissioner in writing of its intention to amend the management agreement at least 30 days prior to entering into the amendment as required by U.C.A. § 31A-16-106(1)(b)(iv). A Form D, Prior Notice of a Transaction, with regard to the amendment was filed in September of 2002.

Service fees incurred under the management agreement were:

<u>1999</u>	<u>2000</u>	<u>2001</u>
<u>\$81,624</u>	<u>\$44,278</u>	<u>\$279,440</u>

FIDELITY BOND AND OTHER INSURANCE

The minimum fidelity insurance suggested by the National Association of Insurance Commissioners ("NAIC") for a company of the Organization's size and premium volume was \$75,000 to \$100,000. The Organization was a named insured under a financial institutional bond providing coverage up to a single loss limit of \$800,000 with a deductible of \$25,000. Directors' and officers' liability insurance had an aggregate limit of \$1,000,000.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Organization did not have any employees. Officers were covered under the Association's pension and insurance plans.

STATUTORY DEPOSITS

Pursuant to U.C.A. § 31A-8-211, the Organization was required to maintain a statutory deposit of \$550,000. Key Bank held U.S. Treasury Notes with a par value of \$550,000 and a statement value of \$556,157 under a tri-party agreement with the Department. The deposit was held for the benefit of all policyholders, claimants, and creditors of the Organization.

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting

A concurrent market conduct examination compared the Organization's list of department filings with forms filed with the department. No discrepancies were noted. The Organization's maximum retained risk for any single individual was \$1,500.

Territory and Plan of Operation

The Organization was authorized to conduct HMO business only in the State of Utah. The Organization furnished health care services through arrangements with providers to enrollees in return for periodic payments. The Organization was obligated to arrange for available and accessible health care. The Organization's plan of operations utilized both leased access to health care networks, consisting of physicians, hospitals and other health care providers, and direct contracts with hospitals and physicians outside the network. The Organization's provider contracts, with the exception of capitated dental providers, were on a fee for service basis.

The Association provided marketing services to the Organization through an administrative services agreement. The Organization's products were marketed through an affiliated brokerage firm on a personal contact basis. In addition, the Association provided seminars, training sessions, and faculty meetings with employer groups. Other services provided included brochures and descriptions of the Organization's plans, which the Association delivered to employer groups within the Organization's authorized service area.

Advertising and Sales Material

Sales material was reviewed in a concurrent market conduct examination. The Organization's policies were marketed through an affiliated brokerage firm on a personal contact basis. The material included packets given to potential clients and to employees after enrollment into a plan. No material exceptions were noted in a comparison of sales materials to related policies.

Treatment of Policyholders

Complaint handling procedures and a sample of complaints were reviewed in the concurrent market conduct examination. The examination determined that the Organization maintains some control over policyholder complaints and that policyholders are being treated fairly. During the examination period, eight complaints were filed with the Department.

The Association had written grievance procedures in place that applied to all affiliated insurers. An insured could request a review of a claim that had been denied by writing to the claims review committee. If the insured did not agree with the findings of this committee, the insured could request a review by the executive committee. If dissatisfied with the decision of the executive committee, the insured could request a review by the board of directors. If still dissatisfied, the insured could make a written request for arbitration. Arbitration was final if the amount in question was greater than the jurisdiction of the small claims court. The insured was required to exhaust all administrative remedies before initiating any action in small claims court.

REINSURANCE

Assumed:

The Organization did not assume reinsurance.

Ceded:

Effective January 1, 1999, the Organization entered into an agreement with the Association to cede 100 percent of certain group medical plans issued to educational groups and affiliated organizations. The Organization agreed to pay premiums monthly, in arrears, in accordance with the following net rates:

Minimum:	99% of total direct premium
Provisional:	100% of total direct premium
Maximum:	101% of total premium

The final premium for each calendar year the agreement is in effect is based on insured claims through the end of the calendar year. It is determined by multiplying the Organization's incurred losses applicable to the reinsurance period by 100/90. The final premium is subject to the minimum and maximum premiums shown above. The premiums are not subject to commissions

or expense allowances. The following schedule reflects the reinsured premiums for the years 1999 through 2001:

<u>1999</u>	<u>2000</u>	<u>2001</u>
\$97,456,735	\$59,311,882	\$6,856,453

As of the examination date, the Organization was a named insured on two specific medical excess of loss reinsurance agreements with General & Cologne Life Re of America. The first excess treaty provided coverage in excess of \$300,000 per person, per agreement year, not to exceed an amount of \$700,000 per person, per agreement year. The second excess treaty provided coverage in excess of \$1,000,000 per person, per agreement year, not to exceed \$1,000,000 per person, per agreement year.

ACCOUNTS AND RECORDS

The Association provided accounting and other administrative services under an administrative services agreement. The Association's accounting system utilized a centralized computer record processing system, supplemented by ancillary records maintained manually or on personal computers. An examination trial balance, as of December 31, 2001, was prepared from the Organization's general ledger. Account balances were traced to annual statement reports, exhibits, and schedules without exception. Individual account balances for the examination period were examined as deemed necessary.

Accounts and records deficiencies included the following:

- The following annual statement schedules, note to financial statements, and general interrogatories were not properly completed:
 - Schedule Y, Part 2;
 - Schedule S, Part 6;
 - Note number 27; and
 - General Interrogatories 1.1, 3.2, 4.3, and 14.
- An administrative sweep account that met the definition of cash equivalent as specified by NAIC Accounting Practices and Procedure Manual, SSAP No. 2, was incorrectly reported as a short-term investment.
- Securities acquired through a broker were held by the broker for up to eleven months before being transferred to a custodial account. U.C.A. § 31A-4-108 requires an insurer to hold all investments in its own name except securities kept under a custodial agreement or trust arrangement and securities that may be acquired and held in bearer form. Subsequent to the examination date, instructions were issued to the broker to transfer the securities to a custodial account in a timely manner.

FINANCIAL STATEMENT

The Organization's financial condition as of December 31, 2001, and the results of its operations during the twelve months then ended, as determined by examination, are reported in the following financial statements:

Balance Sheet as of December 31, 2001

Statement of Revenue and Expenses – January 1, 2001 through December 31, 2001

Capital and Surplus – January 1, 2000 through December 31, 2001

The accompanying comments on financial statement are an integral part of these statements.

Educators Health Care
Balance Sheet
As of December 31, 2001

ADMITTED ASSETS

	<u>Amount</u>	<u>Notes</u>
Bonds	\$ 867,885	
Preferred stocks	204,575	
Common stocks	195,058	
Cash and short-term investments	1,253,777	
Accident and health premiums due and unpaid	35,565	
Investment income due and accrued	20,022	
Amounts due from parent, subsidiaries and affiliates	27	
Total assets	<u>\$ 2,576,909</u>	

LIABILITIES

Claims unpaid	\$ 189,333	(1)
Unpaid claims adjustment expenses	5,680	(2)
Aggregate policy reserves	0	(3)
Premiums received in advance	2,385	
General expenses due or accrued	40	
Amounts due to parent, subsidiaries and affiliates	204,917	
Total liabilities	<u>402,355</u>	
Common capital stock	330,000	
Unassigned funds (surplus)	1,844,554	
Total capital and surplus	<u>2,174,554</u>	
Total liabilities, capital stock and surplus	<u>\$ 2,576,909</u>	

Educators Health Care
Statement of Revenue and Expenses
January 1, 2001 through December 31, 2001

	<u>Amount</u>
Net premium income	\$ 3,028,477
Change in unearned premium reserves and reserve for rate credits	<u>5,941</u>
Total revenues	<u>3,034,418</u>
Hospital/medical benefits	7,766,970
Other professional services	3,394,946
Emergency room and out-of-area	<u>178,133</u>
Subtotal	11,340,049
Net reinsurance recoveries	<u>9,326,333</u>
Total medical and hospital	2,013,716
Claims adjustment expenses	87,791
General administrative expenses	<u>243,804</u>
Total underwriting deductions	<u>2,345,311</u>
Net underwriting gain or (loss)	689,107
Net investment income earned	<u>82,616</u>
Net income	<u><u>\$ 771,723</u></u>

Educators Health Care
Capital and Surplus
January 1, 2000 through December 31, 2001

	Per Exam	
	2000	2001
Capital and surplus December 31, previous year	<u>\$ 1,111,022</u>	<u>\$ 1,377,301</u>
Net income (loss)	357,873	771,723
Net unrealized capital gains and losses	(41,656)	(24,408)
Change in non-admitted assets and related items	<u>(49,938)</u>	<u>49,938</u>
Net change in capital and surplus for the year	266,279	797,253
Capital and surplus, December 31, current year	<u>\$ 1,377,301</u>	<u>\$ 2,174,554</u>

COMMENTS ON FINANCIAL STATEMENT

(1) Unpaid claims

\$ 189,333

Unpaid claims adjustment expenses in the amount of \$5,680 were improperly reported as unpaid claims. In accordance with annual statement instructions, the reserve for the estimated expenses necessary to adjust unpaid claims was reclassified to unpaid claims adjustment expenses.

(2) Unpaid claims adjustment expenses

\$ 5,680

Unpaid claims adjustment expenses were improperly reported as unpaid claims. In accordance with annual statement instructions, the reserve for the estimated expenses necessary to adjust unpaid claims was reclassified from unpaid claims.

(3) Aggregate policy reserves

\$ 0

Contrary to guidance provided by NAIC Accounting Practices and Procedure Manual, SSAP No. 54, Section 21, the Organization reported a decrease of \$5,941 in capital and surplus resulting from a change in valuation basis of aggregate policy and claims reserves. A change was not made. A reversal of the reported change eliminated this liability.

CAPITAL AND SURPLUS

The Organization's capital and surplus was determined to be \$2,174,554. An immaterial increase of \$5,941 was made to capital and surplus (Refer to **COMMENTS ON FINANCIAL STATEMENT** – comment 3).

U.C.A. § 31A-8-209(1) required the Organization to maintain minimum capital in the amount of \$100,000. U.C.A. § 31A-8-209(4) required the Organization to maintain minimum assets in an amount equal to the total of the Organization's liabilities, minimum capital, and the company action level RBC as defined in U.C.A. § 31A-17-601(8)(b). The Organization had sufficient assets to meet the capitalization requirements as of December 31, 2001, as shown below:

Admitted Assets	<u>\$ 2,576,909</u>
Liabilities	<u>402,355</u>
Minimum Capital	100,000
Company Action Level RBC	<u>260,832</u>
Total	<u>763,187</u>
Assets in Excess of Minimum Requirement	<u><u>\$ 1,813,722</u></u>

Subsequent to the examination date, U.C.A. § 31A-8-209 was amended to require each health maintenance organization to have and maintain qualified assets in an amount not less than

the total of its liabilities, minimum capital, and the greater of the company action level RBC or \$1,300,000.

SUMMARY


Items of significance or special interest contained in this report are summarized below:

- As also noted in prior examination reports, the articles of incorporation were not in compliance with U.C.A. § 31A-8-204(1) and (2). Subsequent to the examination date, Restated Articles of Incorporation and amended and restated bylaws were filed with the Department. **(HISTORY – General)**
- As also noted in the prior examination report, the Organization's bylaws required that the directors and officers be the same as the Association. U.C.A. § 31A-8-215 applies U.C.A. 31A-5, Part IV to HMOs. U.C.A. § 31A-5-408(2) requires shareholders to elect directors. The Organization was not in compliance with this requirement. **(HISTORY – Management)**
- As also noted in the prior examination report, several directors listed interests that may give actual or potential conflict with his/her duties or judgment. **(HISTORY – Conflict of Interest Procedure)**
- U.C.A. § 16-10a-701 requires the Organization to hold an annual shareholders meeting. No shareholder meetings were held during the examination period. The prior examination report also noted that shareholder meetings were not held. **(HISTORY – Corporate Records)**
- U.C.A. § 31A-8-215 requires that the board of directors manage the business and affairs of the Organization. A review of corporate minutes indicated that the board did not adequately approve and support the Organization's transactions and events. **(HISTORY – Corporate Records)**
- The Organization did not notify the Commissioner in writing of its intention to amend a management agreement at least 30 days prior to entering into the amendment as required by U.C.A. § 31A-16-106(1)(b)(iv). **(AFFILIATED COMPANIES)**
- Effective January 1, 1999, the Organization entered into an agreement with the Association to cede 100 percent of certain group medical plans issued to educational groups and affiliated organizations. **(REINSURANCE)**
- Several accounts and records deficiencies were identified. **(ACCOUNTS AND RECORDS)**

CONCLUSION

Assistance and cooperation extended during the course of the examination by officers, and representatives of the Organization are acknowledged. In addition to the undersigned, Donald R. Catmull, Financial Examiner, participated in the examination. John Kay, CFE, CIE, Assistant Chief Examiner, supervised the examination.

Respectfully submitted,


C. Kay Anderson, CFE
Examiner-in-Charge, Representing the
Utah Insurance Department